STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Ameren Illinois Company	:	
Proposed general increase in electric delivery service rates	:	Docket No. 11-0279 (Cons.)
Proposed general increase in gas delivery service rates.	:	Docket No. 11-0282

Rebuttal Testimony of
Scott J. Rubin

on Behalf of
the People of the State of Illinois and
the Citizens Utility Board

AG/CUB Exhibit 5.0

August 23, 2011

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Introduction and Summary

Q. Please state your name.

A. My name is Scott J. Rubin. I previously submitted direct testimony on behalf of the Office of Attorney General ("AG") and the Citizens Utility Board ("CUB"), which has been labeled AG/CUB Exhibit 2.0.

Q. What is the purpose of your rebuttal testimony?

A. I have been asked by the AG and CUB to review the portions of the rebuttal testimony and exhibits filed by Ameren Illinois Company ("Ameren" or "Company"), as well as direct testimony filed on behalf of the Illinois Industrial Energy Consumers ("IIEC"), as they relate to the gas and electric cost-of-service studies ("COSS") and residential rate designs.

Specifically, I will be discussing portions of the testimonies of Ameren witnesses Jones (Ameren Ex. 31.0) and Althoff (Ameren Ex. 33.0) and IIEC witnesses Stephens (IIEC Ex. 1.0) and Stowe (IIEC Ex. 2.0).

Response to Ameren Witness Jones

Q. Have you reviewed the rebuttal testimony of Ameren witness Leonard Jones?

A. Yes, I have reviewed the portion of Mr. Jones's rebuttal testimony that relates to my direct testimony (Ameren Ex. 31.0, pages 39-43).

Distribution Tax

Q. Mr. Jones disagrees with your recommendation to immediately require all customers to pay the same distribution tax rate. How do you respond?

A. Mr. Jones and I obviously disagree about the appropriate way to implement public policy in this case. There is no factual dispute between us. I think we both agree that there is a general regulatory policy that promotes gradualism of rate changes and that is sensitive to the impact of rate changes on customers. In this instance, however, I believe that the Illinois legislature has effectively superseded this general regulatory policy by imposing a tax on each kilowatt-hour ("KWH") of electricity sold in the state (with some variations depending on the size of the distribution utility). In my opinion, therefore, the Commission should implement the legislature's policy and impose the same tax rate on all KWH sold by Ameren. To do otherwise would elevate a general regulatory policy or philosophy over a specific statute enacted by the legislature. I continue to recommend that all KWH sold by Ameren should pay the same level of state distribution tax, and the current tax subsidies received by large users of electricity should be eliminated at the conclusion of this case.

Q. On page 41 of his rebuttal, Mr. Jones states that your concerns with the distribution tax rate in Rate Zone II are not workable. How do you respond?

A. In my direct testimony (AG/CUB Ex. 2.0, 9:179-194), I took issue with Ameren's proposal to <u>increase</u> the tax rate paid by residential (DS-1) customers in Rate Zone II, even though those customers already are paying a tax rate in excess of the statutory rate.

After paying this increased rate in year 1, the rate then would be reduced. I explained that this is an absurd method to lower the DS-1 class's tax rate in Rate Zone II. Classes that already are paying a higher-than-required tax rate should not receive any increase, even if the Commission adopts Ameren's three-year phase-in proposal.

Mr. Jones disagrees with my concern because he claims there is no choice; that in order to provide a sufficient subsidy to large users (DS-4 customers), the DS-1 rate must increase. As he puts it: "So, if Rate Zone II charges to DS-1 – DS-3, and DS-5 are capped at no more than the average effective Distribution Tax cost of $0.0012936/kWh, there are no classes within Rate Zone II left to pay for the subsidy to DS-4. It is certainly not reasonable to move these costs for Rate Zone II over to DS-1 – DS-3 and DS-5 customers within Rate Zone I and III." Ameren Ex. 31.0, 41:856-860.

I disagree with Mr. Jones. I never said that the DS-1 rate should be capped at no more than the average tax rate during a phase-in; I said that the DS-1 rate should not increase above its current rate (which already exceeds the average tax rate) during the phase-in period.

Moreover, it is possible to design a phase-in that meets that standard. On AG/CUB Ex. 5.1, I show how such a phase-in would work. I neither increase nor decrease the rate paid by DS-1 and DS-2 customers in year 1, with the result that those classes would continue to subsidize the DS-4 class. The rates paid by DS-3 and DS-5 customers would increase to the average tax rate, which is a much smaller increase than Ameren recommended (inexplicably, Ameren recommended more than doubling the rate paid by DS-3 and DS-5 customers, from a rate below cost to a rate well in excess of cost).

The resulting rate to DS-4 customers in Year 1 would be significantly higher than the current rate, but still would be below the actual tax rate Ameren is required to pay.

In year 2, as shown on the exhibit, one-half of the subsidy from the DS-1 and DS-2 classes to the DS-4 class is eliminated. In year 3 all customers would pay the same tax rate per KWH.

Q. Under your example, how much is the cumulative subsidy that DS-1 and DS-2 customers in Rate Zone II would pay to DS-4 customers?

A. In my example, during years 1 and 2 DS-1 and DS-2 customers in Rate Zone II would pay a subsidy of more than $308,000 to DS-4 customers.

Q. What do you recommend?

A. I continue to recommend that all customers should pay the same tax rate per KWH. If, however, the Commission finds that the tax rate should be phased in over three years, the phase-in should be designed so that customers who already are paying more than the required tax rate should not receive an increase. This is a concern only in Rate Zone II under Ameren's proposal. As I show in my exhibit, it is possible to design a three-year phase-in for Rate Zone II that does not increase the rates to DS-1 and DS-2 (the classes already paying more than the required tax rate) and still provide some relief to Ameren's largest customers (DS-4).

Electric Customer Charge

Q. On pages 41-43 of his rebuttal, Mr. Jones disagrees with your proposal to keep Ameren's electric customer charges at their current level. How do you respond?

A. Mr. Jones claims that Ameren's proposal is cost-based, but he does not cite to any cost data. As I demonstrated in my direct testimony, under any reasonable measure of the costs that should be recovered through the customer charge, Ameren's existing customer charge exceeds the cost of service. Thus, there should not be any increase in the customer charge. Instead of relying on cost data, Mr. Jones's rebuttal is actually a policy argument claiming that it is reasonable for an electric utility to move toward a straight-fixed-variable ("SFV") type of rate design.

Q. On page 42, Mr. Jones cites to several cases where the Commission has authorized movement toward an SFV type of rate design. How do you respond?

A. I addressed this issue in the portion of my direct testimony relating to natural gas rate design (AG/CUB Ex. 2.0, pages 13-19) and the same concerns would apply here. Mr. Jones fails to recognize that unlike most of the gas utilities to which Mr. Jones cites, Ameren's residential (DS-1) electricity consumption has been <u>increasing</u> over the years. This means that the revenues collected from the DS-1 class are likely to provide Ameren with at least the level of revenues it projects in a rate case. In an environment of stable or increasing consumption, there is no justification to deviate from cost-of-service in order to help promote a utility's revenue stability. (As I explained in my direct testimony, there

are different reasons why Ameren should stop moving toward SFV rates for its gas utility operations.)

Q. How do you know that Ameren's residential consumption has been increasing?

A. This is the third Ameren rate case that I have reviewed for the AG and/or CUB. In the first case (docket 06-0070, et al.), Ameren projected total residential consumption of 11,006,767,488 KWH. In the next case (docket 07-0585, et al.), Ameren projected total residential consumption of 11,527,699,296 KWH. In the current case, Ameren is projecting total residential consumption of 11,759,121,721 KWH. (The data are taken from the E-5 schedules in each filing.) Thus Ameren's residential consumption has been increasing steadily over the past six or seven years.

Q. On page 43 of his rebuttal, Mr. Jones testifies that the consumption charge for distribution service should be kept lower (by increasing the customer charge) because the Company will be increasing its rates for basic general service. Is this a valid consideration in setting distribution rates?

A. No, it is not. It is my understanding that Illinois has separated distribution rates from generation rates so that competitive suppliers and marketers can attempt to participate in the generation market. There are not supposed to be cross-subsidies between distribution and generation service, and the ratemaking for each service is to remain separate. Further, if generation rates are increasing, that is no reason to require low-use customers to subsidize higher-use customers through distribution rates. Distribution rates should be set in this case without regard to what is happening in the generation market. There is no

reason to require low-use customers to pay more on their bills to ease the burden that higher-use customers might feel on the generation portions of their bills.

Q. Mr. Jones states that under his proposed design, a customer who consumes more kWh will pay more, even though the cost of serving the customer has not changed because the majority of costs to serve customers are fixed. (page 42, lines 872-875). Do you agree with his assertion that if a customer consumes more kWh the cost to serve that customer has not changed?

A. No, I do not agree with Mr. Jones. His testimony seems to be based on a very short-run view of fixed and variable costs, and that is not an appropriate way to set utility rates. In the short-term, it is true that most of a utility's costs are fixed because the capital the utility has invested cannot be changed. In the long-term, however, almost all of a utility's costs are not fixed, because the size of the capital investment will depend upon the consumption of its customers. If the costs of those capital investments are not recovered in relation to the consumption which prompted that investment, customers will get an incorrect price signal. For example, Ameren is spending millions of dollars each year to upgrade its electric distribution network. That investment is required because customers' demand for electricity is increasing. Each time a transformer or line or other facility is upgraded, Ameren evaluates the likely demands the facility must meet. While these investments become "fixed" once they are made, the reason why the cost was incurred was to meet energy demand, and the prices charged to customers should reflect the fact that increased demand for electricity causes increases in distribution costs.

A simple way to look at this problem is to consider the case of service on a single residential street. The lines, transformers, and other facilities on that street are not the same today as they were in 1960. Today customers use electricity in very different ways than they did 50 years ago – microwave ovens, computers, cell phone chargers, high-definition televisions, DVD players, video game systems, dishwashers, central air conditioners, and numerous other appliances have caused average residential electricity usage to increase dramatically from what it was 50 years ago. If the electric distribution system were the same today as it was in 1960, customers would experience frequent outages because the system simply was not designed to meet that level of demand.

The same is true today. On that same residential street as it exists today, if every customer increased their demand by 50% over the next year, the system would need to be upgraded and costs would increase. The system is sized to meet the demand that is expected to be put on the system. Increased consumption requires changes to the system. In other words, there is a cost associated with increased consumption.

Meeting customers' increasing demand for electricity is expensive and rates should reflect that fact. If rates are set based on the fictitious notion that there is no cost associated with increased demand for electricity, then customers will lose the price signal that helps to control that level of demand. If that were to occur, then facilities would become obsolete more quickly (transformers and lines would become overloaded, for example) and costs would rise at a faster rate than necessary. The fundamental principle of cost-of-service and rate design – setting rates to mirror <u>cost causation</u> (that is, <u>why</u>

costs are incurred) – would be violated if Mr. Jones's short-term pricing philosophy were applied.

Q. Mr. Jones also states that assessing a customer charge that recovers more than the traditional "customer related costs" in a cost study is still cost based. (page 42, lines 874-875). Do you agree?

A. No, I do not agree. A cost-of-service study determines whether costs are customer-related, demand-related, or energy-related. If some of the demand-related costs are recovered through the customer charge, as Mr. Jones proposes, then the customer charge no longer reflects the cost of service. Some of the demand-related costs incurred to serve higher-use customers would be paid by low-use customers. Those low-use customers would be subsidizing higher-use customers and the rates would not be cost-based.

Response to Ameren Witness Althoff

Q. Have you reviewed the rebuttal testimony of Ameren witness Karen Althoff?

A. Yes, I have reviewed the portion of Ms. Althoff's rebuttal testimony that relates to my direct testimony (Ameren Ex. 33.0, pages 17-25).

Q. Does Ms. Althoff provide any new information that is relevant to the concerns you raised in your direct testimony?

A. No, she does not. Ms. Althoff provides statistics about customers who receive LIHEAP assistance, but that information is not relevant to my testimony. I never claimed, as Ms. Althoff suggests, that low-income customers used less gas than higher-income

customers. When I spoke about "discrimination" and "social welfare" in my direct testimony, it had nothing to do with customers' income levels or other socioeconomic characteristics. I was testifying solely about rate discrimination and social welfare in an economic sense. Social (or societal) welfare as I used the term applies to the total value to consumers of the product or service; not to any individual customer's use of the service. In economic theory, there are pricing methods that can improve overall social welfare by improving the efficiency with which consumers use the service. The Company's pricing proposal is not such a pricing method. It simply shifts cost from high-use customers to low-use customers, but it does nothing to improve the overall efficiency of service. In fact, as I have explained, it actually could lead to inefficient consumption decisions because consumers would not receive a price signal reflecting the true cost of meeting customers' demands for energy services.

My concern with the Company's proposed gas rate design is with low-use customers and the Company's proposal to have those customers pay higher rates so that high-use customers can pay lower rates. As Ms. Althoff states, we do not know the incomes of low-use customers, which is why I never claimed that there was any type of correlation between gas usage and income. This is particularly the case for gas customers who receive LIHEAP assistance, since those customers – by definition – must use gas for space heating. I would expect most low-use gas customers to be non-heating customers. Any low-income non-heating customers would assign their LIHEAP grants to their heating provider (most likely an electric utility).

Q. On page 24, Ms. Althoff lists the types of costs she considers "fixed." Do you agree with her?

A. No, I do not agree with her. It is interesting to note that she includes storage fields in her definition of fixed costs that "are required regardless of therm usage." This is not correct and it is directly contrary to the approach taken by other major gas utilities in Illinois. In the current rate case for Peoples Gas and North Shore Gas, Docket No. 11-0280/0281, those utilities have proposed to create a separate rider to recover storage costs. For the residential class, they propose to recover such costs on a per-therm basis because they recognize that storage costs are directly associated with customers' gas demands.

Moreover, storage fields are valuable assets whose capacity can be sold to energy marketers and others who need to store natural gas. Thus, if retail customers reduce their demands for natural gas, the utility may be able to sell some of its storage capacity to others. This is truly a variable cost, not a fixed cost, as Peoples Gas and North Shore have recognized in their current case.

Q. Are storage costs a significant part of Ameren's so-called fixed costs?

A. Yes. Ameren Ex. 13.2G shows that for the residential (GDS-1) class, storage costs amount to $17,193,500, which is approximately 7.3% of Ameren's total residential revenue requirement of $234,967,300.

Q. If storage costs are treated as energy (or demand) costs for residential customers, as Peoples Gas and North Shore have proposed, how would it affect the calculation of so-called fixed-cost recovery for Ameren?

A. If storage costs are removed from fixed costs, and if the Commission continues to set the GDS-1 customer charge to recover 80% of fixed costs, then the customer charge should be no more than $19.33 under Ameren's proposed revenue requirement. I calculate this amount from the data shown on Ameren Ex. 13.2G, as follows:

Total GDS-1 fixed costs = GDS-1 total costs – GDS-1 storage costs
= $234,967,300 - $17,193,500 = $217,773,800

80% of total GDS-1 fixed costs = $217,773,800 x 0.80 = $174,219,040

GDS-1 customer charge = 80% of total GDS-1 fixed costs / GDS-1 bills
= $174,219,040 / (751,119 customers x 12 bills per customer) = $19.33

Q. Do you have any other response to Ms. Althoff's testimony?

A. No, I do not. Ms. Althoff and I obviously disagree about the appropriate way to design rates and implement public policy in this case, but other than her inclusion of storage costs as being fixed, I do not believe there is a significant factual dispute between us.

Response to IIEC Witness Stephens

Q. Have you reviewed the direct testimony of IIEC witness Robert Stephens?

A. Yes, I have reviewed Mr. Stephens's direct testimony (IIEC Ex. 1.0). I will be responding to the portion of his testimony that relates to the collection of the distribution tax (pages 19-36).

Q. Mr. Stephens states that the tax is not strictly related to the number of kilowatt-hours used by customers. Is he correct?

A. No, he is not correct. Mr. Stephens is correct about the history of the tax and how it was modified as part of the restructuring of the electric industry in Illinois, but that history is irrelevant to the current imposition of the tax. Indeed, on page 22 of his testimony, Mr. Stephens has a table that shows that the tax is levied solely based on the number of KWH used by the utility's customers. While the rates charged are a sliding scale that varies with consumption, the only basis for imposing the tax is KWH consumption.

Q. How do the tax rates in Mr. Stephens's table compare to the rates currently charged by Ameren to its largest (DS-4) customers?

A. Ameren's largest customers (the DS-4 class) have been paying rates that are substantially lower than even the lowest tax rate that would apply to Ameren. Specifically, I calculate from Ameren's Schedule E-5 that DS-4 customers are estimated to use 15,772,537,910 KWH in the test year. If those were Ameren's only customers, Ameren would have a tax liability of $21.7 million. This illustration would give DS-4 customers exclusively the benefit of the low tax rates imposed on the first 4 billion KWH per year, as shown in Mr. Stephens's table. Yet DS-4 customers currently are paying less than $5 million in revenues for the tax – a shortfall of more than $16 million. Interestingly, using Ameren's overall average tax rate lowers the DS-4 class's tax liability by more than $1 million to $20.4 million (because of the lower tax rate that takes effect for consumption over 18 million KWH). I show all of these calculations on AG/CUB Exhibit 5.2.

Mr. Stephens's attempts to place the blame on the graduated nature of the tax tables must fail. If DS-4 customers were Ameren's only customers, the class's tax liability would be even higher than it is under Ameren's average tax rate. In either event, there is no question that the DS-4 class is being heavily subsidized – to the tune of at least $15 million – by the DS-1 and DS-2 customer classes.

Q. Does Mr. Stephens's testimony cause you to change any of your conclusions or recommendations?

A. No. The Commission should reject Mr. Stephens's attempts to confuse the real issue with discussions of the history of the tax and the graduated rates used in the tax calculation. There is no question that Ameren's largest customers (the DS-4 class) have not been paying their fair share of this tax. In my opinion, it is time for this subsidy to end.

Response to IIEC Witness Stowe

Q. Have you reviewed the direct testimony of IIEC witness David Stowe?

A. Yes, I have reviewed Mr. Stowe's direct testimony (IIEC Ex. 2.0) concerning Ameren's cost-of-service studies ("COSS").

Q. Has Ameren addressed any of Mr. Stowe's issues in its rebuttal testimony?

A. Yes, Ameren witness Schonhoff (Ameren Ex. 32.0) does a good job of rebutting Mr. Stowe's proposed changes in the COSS.

Q. Specifically let's turn to the issue of the alleged minimum distribution system ("MDS") that Mr. Stowe discusses beginning on page 10. How do you respond to his general advocacy for the use of MDS in allocating the costs of certain distribution facilities?

A. Mr. Stowe reiterates arguments that have been made to this Commission for at least the past 15 or 20 years in numerous electric rate cases. The Commission has consistently rejected attempts by large users to shift distribution costs onto smaller users through the use of a hypothetical minimum system.

Q. Is it reasonable to assume that the costs of meeting the National Electrical Safety Code ("NESC") minimum standards are solely related to the number of customers served, as Mr. Stowe asserts?

A. No, absolutely not. The NESC minimum standards are based on the assumption that customers will actually use electricity. Further, minimum construction standards are based not on the number of customers, but on the expected electricity consumption of those customers, as well as other factors such as topography; population density; building type; the proximity of electrical facilities to railways, water, and other natural or man-made features; and other factors. Indeed, there is no single construction standard in the NESC. Rather, it contains dozens of pages with standards and safety considerations for various types of circumstances. See generally Part 2 of the NESC (Safety Rules for the Installation and Maintenance of Overhead Electric Supply and Communication Lines), which covers approximately 120 pages.

Moreover, in 2000, the National Association of Regulatory Utility Commissioners (NARUC) Committee on Energy Resources and the Environment commissioned a paper from the Regulatory Assistance Project to examine various rate design and cost allocation issues associated with a restructured electric industry. The paper is entitled: "Charging for Distribution Utility Services: Issues in Rate Design." One of those issues is the allocation of distribution-related costs. The paper discusses MDS and notes several problems and inconsistencies with this approach, including the following:

> However, the distinction between customer and demand costs is not always clear, insofar as the number of customers on a system (or particular area of a system) will have impacts on the total demand on the system, to the extent that their demand is coincident with the relevant peak (system, areal, substation, etc.).
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> In the case of the minimum-size and zero-intercept methods, the threshold assumption is that there is some portion of the system whose costs are unrelated to demand (or to energy for that matter). From one perspective, this notion has a certain intuitive appeal – these are the lowest costs that must be incurred before any or some minimal amount of power can be delivered – but from another viewpoint <u>it seems absurd, since in the absence of any demand no such system would be built at all</u>.
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> The zero-intercept method attempts to model a system that has no demand-serving capability whatsoever, but <u>what remains is not necessarily a system whose costs are driven any more by the number of customers than it is by geographical considerations, whose causative properties are neither squarely demand- nor customer-related</u>. (p. 30, emphasis added)

In other words, the NARUC study recognized that while a minimum system might exist, it cannot be concluded that this minimum system is related to the number of customers.

It also correctly states that if customers do not demand electricity, they would not be customers and no system would be built at all.

The NARUC study identifies the issues that are precisely the problem with Mr. Stowe's testimony. He discusses at great length how the NESC standards could be used to determine the minimum distribution system, but he fails to show that such costs are related solely to the number of customers, rather than to the numerous other factors that affect the construction of distribution facilities. He also neglects to discuss why such a system would be built in the absence of any demand for electricity.

Finally, as Ameren witness Schonhoff discusses, Mr. Stowe committed two serious errors in his MDS analysis (Ameren Ex. 32.0, pages 15-18). First, Mr. Stowe failed to apply his methodology to all relevant accounts. Second, Mr. Stowe failed to recognize that once his alleged minimum system is built, there would be relatively little incremental residential demand left to be served. Instead, Mr. Stowe continued to use the entire DS-1 class's demand to allocate the remaining demand-related costs. I agree with Mr. Schonhoff's testimony on both of these issues.

Q. What do you conclude about Mr. Stowe's testimony?

A. I conclude that the Commission should reject Mr. Stowe's proposal to reallocate certain distribution costs using MDS. MDS does not have a sound theoretical basis and the Commission has consistently rejected this methodology. Moreover, Mr. Stowe's attempt to construct a hypothetical system that complies with minimum requirements of the National Electrical Safety Code contains serious errors that greatly overstate costs to DS-1 customers and understate costs to Mr. Stowe's clients.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.